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Nos. 71-632, 71-637

In the Supreme Court of the United States

OCTOBER TERM, 1971

A. DANA HODGDON, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

JAMES F. HAIGHT, ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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OPINIONS BELOW

The court of appeals wrote no opinion. The opinion of the Commission (Pet. App. 1b-46b)[1] is not yet reported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 1a) was entered on June 30, 1971. On August 12, 1971, a timely petition for rehearing was denied (Pet. App. 1g). The petition for a writ of certiorari in No. 71-632 was filed on November 9, 1971, and the petition in No. 71-637 was filed on November 10, 1971. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether it was proper for the Commission to refuse to furnish petitioners in advance of hearing with (a) the names of the customers whom they were charged with having defrauded, and (b) a particularized statement of the precise acts they were charged with having committed, where there was no showing that petitioners were unable adequately to prepare and present their defense or were otherwise prejudiced.

2. Whether the Commission was precluded from finding that petitioners had engaged in a scheme to defraud public investors and from imposing remedial sanctions merely because there was no showing that

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[1] "Pet." and "Pet. App." refer to the petition and appendix in No. 71-632.

these customers had suffered pecuniary losses as a result of the scheme.

STATEMENT

Petitioners seek review of the *per curiam* affirmance (Pet. App. 1a) of an order of the Commission barring each of them from association with any broker or dealer (Pet. App. 45b-46b).[2] In its findings and opinion, the Commission found that between 1960 and 1964 all of the petitioners willfully violated the antifraud provisions of the federal securities laws[3] by engaging in a scheme to defraud public investors (Pet. App. 2b-24b).

The Commission made the following findings: By means of high-pressure customer-solicitation techniques—including carefully-planned emotional appeals to fear and greed and deceptive advertisements—petitioners held themselves out as investment experts and specialists who would provide unique comprehensive financial planning services to their clients (Pet. App 3b-4b, 7b). In reality, petitioners embarked on a systematic program under which seasoned,

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[2] The order also revoked the broker-dealer registration of Haight & Co., the firm with which petitioners were associated, and expelled that firm from membership on the Philadelphia-Baltimore-Washington Stock Exchange and in the National Association of Securities Dealers, Inc. (Pet. App. 46b). The firm is not a petitioner herein.

[3] Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), and Sections 10(b) and 15(c)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b) and 78o(c)(1) and Rules 10b-5 and 15c1-2 thereunder, 17 C.F.R. 240.10b-5 and 240.15c1-2.

blue-chip stocks in their clients' portfolios were replaced with mutual fund shares and new issues (including speculative stocks and real estate syndications); unknown and undisclosed to the clients, this program was designed to sell securities which would result in the greatest gain to petitioners, rather than to promote the interests of the clients (Pet. App. 21b). To lull their clients into a false sense of security and to forestall complaints, petitioners sent false and misleading "progress reports" to clients, told them to consider petitioners as doctors who could diagnose financial ills and instructed them to ignore prospectuses covering speculative securities (Pet. App. 9b-23b).

In addition to finding that all of the petitioners participated in the above scheme to defraud, the Commission found that (a) all of them, except David Adam, further violated the antifraud provisions in Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act by making materially false and misleading statements in connection with the offer and sale of particular securities (Pet. App. 24b-31b), and (b) certain of the petitioners violated various other provisions of the federal securities laws (Pet. App. 32b-36b).

The court of appeals affirmed the Commission's order, noting that the Commission had complied with the required procedures and that its findings were supported by substantial evidence (Pet. App. 1a).

ARGUMENT

1. In challenging the standards of due process applied by the Commission in this case, petitioners mis-

construe the nature of the congressionally-mandated administrative processes pursuant to which the Commission may impose remedial sanctions upon an individual who has been found to have violated the federal securities laws. Petitioners' repeated characterization of the Commission's proceedings as "punitive" (Pet. 10, 11) is directly contrary to the uniformly-held view that broker-dealer proceedings are a "remedial device for the protection of the public * * *", the objective of which is to exclude from the securities industry persons who have shown themselves unfit for the professional responsibilities entailed by dealing with public investors.[4] *Associated Securities Corp.* v. *Securities and Exchange Commission*, 283 F. 2d 773, 775 (C.A. 10). Accord, *e.g.*, *Berko* v. *Securities and Exchange Commission*, 316 F. 2d 137, 143 (C.A. 2); *Blaise, D'Antoni & Associates, Inc.* v. *Securities and Exchange Commission*, 289 F. 2d 276 (C.A. 5), rehearing denied *per curiam*, 290 F. 2d 688 (C.A. 5); *Pierce* v. *Securities and Exchange Commission*, 239 F. 2d 160, 163 (C.A. 9).[5] In

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[4] In *Securities and Exchange Commission* v. *Capital Gains Research Bureau*, 375 U.S. 180, 186, this Court emphasized those responsibilities, stating:

> A fundamental purpose, common to these [securities] statutes, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry. * * *

[5] The cases cited by petitioners (Pet. 10, 13, 16) are not to the contrary. Although *Bradley* v. *Fisher*, 13 Wall 335, *Spevack* v. *Klein*, 385 U.S. 511, and *In re Ruffalo*, 390 U.S. 544, indicate that attorney-disbarments are punitive sanctions,

imposing sanctions upon petitioners, the Commission explicitly recognized that its action was designed to serve the public interest (Pet. App. 41b-45b),[6] and not to punish petitioners.

Petitioners' contention reflects a misunderstanding of the nature of broker-dealer proceedings in another

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those proceedings are distinguishable from broker-dealer proceedings under Section 15(b) of the Exchange Act because they are "the product of administrative decision not explicitly authorized by either Congress or the President," and accordingly have not received the same "careful and purposeful consideration by those responsible for enacting and implementing our laws." *Greene* v. *McElroy*, 360 U.S. 474, 507-508. These points of difference are viewed by this Court as relevant and meaningful to a determination of whether a disqualification procedure accords with due process. *Id.* The other cases cited by petitioners are inapposite because they involve sanctions which were so severe—such as deportation and exclusion from employment for disloyalty—that the standards appropriate to criminal proceedings were applicable.

[6] Petitioner Hodgdon asserts (Pet. 11) that "[t]here is no reason to believe that [he] would not in the future proceed with utmost care in * * * the securities field." However, he not only played a principal role in the scheme to defraud (Pet. App. 23b), but also engaged in entirely separate activities constituting violations of the antifraud, registration and recordkeeping provisions of the federal securities laws—violations he does not now contest. The Commission could never impose remedial sanctions if it were required to give preclusive weight to assurances of future compliance with the securities laws. Thus, the weight to be given such assurances and similar mitigating factors must necessarily be left to the Commission's discretion. See, *e.g.*, *O'Leary* v. *Securities and Exchange Commission*, 424 F. 2d 908 (C.A.D.C.). The other petitioners, who refer to themselves as "subordinate" officers or employees of Haight & Co. (Haight Pet. 4), played key roles in the scheme to defraud, as the Commission's opinion shows (Pet. App. 2b-23b), and most of these petitioners were in fact important executive personnel.

important respect when they argue that the Commission gained the power in 1964 to bar persons for life from association with broker-dealers, but has failed since that time to adopt stricter rules of procedure consistent with such power (Pet. 11-12). The Exchange Act, however, has from its inception given the Commission authority effectively to impose a so-called "life-time bar" on an individual's association with any broker or dealer.[7] The controlling basis for the exercise of this power has always been the need to protect the investing public from dealings with securities law violators.

2. Petitioners' primary argument in this case (Pet. 13-18) is that they were unable to prepare a proper defense to the charges in the Commission's eight-page Order for Public Proceedings (Pet. App. 1c-8c) because the order failed to give adequate notice of the charges against them. Specifically, petitioners complain that the order did not identify the customers that petitioners were charged with having defrauded,

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[7] Prior to the 1964 amendments of Section 15(b)(7) of the Exchange Act, Pub. L. No. 88-467, Stat. 570, the Commission could proceed directly against a broker-dealer firm but not against an individual. In proceeding against the firm, however, the Commission could find that an individual willfully violated a provision of the federal securities laws or that he was a cause of a broker-dealer firm's revocation of registration. The former finding could preclude an individual from being associated with any broker-dealer firm if the Commission determined that the public interest so required; the latter finding automatically barred his association with any member of a registered securities association, of which most brokerage firms have been members. Thus, either finding could operate as an effective "life-time bar." See II Loss, *Securities Regulation*, pp. 1314-1323 (1961 ed.).

and that it did not sufficiently identify the precise instances of their allegedly fraudulent conduct.

The order on its face met the notice requirements of the Administrative Procedure Act[8] and petitioners' complaint appears to emanate primarily from the fact that they were alleged to have committed a large number of securities law violations. As noted in *Curtiss-Wright Corp.* v. *National Labor Relations Board*, 347 F. 2d 61, 72 (C.A. 3):

> The propriety of [an administrative] pleading is today judged by its effectiveness as a mechanism for giving an adverse party notice of the claim upon which relief is sought, * * * the absence of specifics being tolerated when there has been no special showing of detriment [footnote omitted]. * * *

There is no showing as to how the preparation of petitioners' defense may have suffered from the claimed lack of specificity in the order. Petitioners concede (Pet. 8) that the hearing examiner granted them information in addition to that contained in the order; they do not claim that they were denied any necessary adjournments in the hearings to meet any surprise evidence that may have been introduced or that they were misled as to the issues in the case. Much of the 108-day hearing (reflected in more than 13,000 pages of testimony and 1,100 exhibits) was de-

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[8] Section 5(a) of that Act, 5 U.S.C. 554(b), requires only that: "Persons entitled to notice of an agency hearing shall be timely informed of (1) the time, place, and nature of the hearing; (2) the legal authority and jurisdiction under which the hearing is to be held; and (3) the matters of fact and law asserted. * * *"

voted to the presentation of evidence and extensive and searching cross-examination by petitioners.

Petitioners' requests for findings of facts and briefs before the hearing examiner and the Commission leave no doubt that petitioners were amply aware of the charges against them; at no point in the hearings did they protest their ignorance of these charges and request further clarification. The flexibility of the administrative process—permitting the fullest exposition of all relevant facts without the inherent limitations that attend court proceedings—fully justifies the absence of any right to pre-hearing discovery,[9] at least where no prejudice has been shown to have resulted.[10]

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[9] *Dlugash* v. *Securities and Exchange Commission*, 373 F. 2d 107, 110 (C.A. 2); *National Labor Relations Board* v. *Chambers Manufacturing Corporation*, 278 F. 2d 715 (C.A. 5); *National Labor Relations Board* v. *Vapor Blast Manufacturing Company*, 287 F. 2d 402 (C.A. 7). Petitioners were, of course, furnished with the pre-hearing statements of witnesses after the witnesses' direct testimony, in compliance with the Commission's Rules of Practice, Rule 11.1, 17 C.F.R. 201.11, and with the standards of the Jencks Act, 18 U.S.C. 3500(a), which the Commission follows in administrative proceedings.

[10] Petitioners' reliance on *Jaffee & Co.* v. *Securities and Exchange Commission*, 446 F. 2d 387 (C.A. 2), is misplaced. In *Jaffe*, the court merely held that the Commission's order for proceedings was deficient because it failed to give notice to the broker-dealer firm of Jaffee & Co. that it might incur derivative liability under Section 15(b)(5) of the Exchange Act because of violations by its principal, Wilton Jaffee. In the instant case, however, no claim can properly be made that petitioners were faced with an unexpected theory of liability. *Bendix Corp.* v. *Federal Trade Commission* (C.A. 6, No. 20687, October 18, 1971), cited by petitioners (Pet. 16), is inapposite for the same reason.

3. In its opinion, the Commission explained that in determining the appropriateness of the sanctions imposed it considered among other things "the ever-developing standards of the securities industry" (Pet. App. 42b). Petitioners erroneously view this reference as an indication that the Commission, in finding that petitioners engaged in the scheme to defraud, was "declaring a particular practice unlawful even though it may not have been so regarded in the past" (Pet. 19). The Commission, however, did not refer to "ever-developing standards" in connection with its findings that petitioners had in fact engaged in a scheme to defraud. Petitioners overlook the distinction between determining the appropriateness of sanctions and determining whether violations of the securities laws have taken place.

In any event, the Commission did not create a "new" fraud violation when it found that petitioners had engaged in a scheme to defraud the public. What the Commission found to be fraudulent was not simply, as petitioners claim (Pet. 21),

> a mode of operation by which a broker-dealer holds itself out as giving financial planning advice and then urges an investment program from which it can earn a greater profit than if it were to choose from a broader list * * *.

As found by the Commission, the scheme was far broader in scope. Petitioners made broad and continuous appeals to public investors—particularly new investors—inducing them to trust petitioners, who were to act as investment experts providing "unique" and

comprehensive investment advice based on the individual needs of the particular customer (Pet. App. 3b-4b). It was not disclosed that the "investment experts" were primarily recently-hired salesmen with little or no previous experience in the securities business or that the comprehensive financial planning service consisted of the systematic emphasis—often in total disregard of the customers' stated investment objectives—on the sale of a relatively small range of securities that would generate for petitioners the highest commissions, sales charges and trading profits, regardless of any benefits that might flow to the investors (Pet. App. 4b-23b).

The fact that the Commission, as petitioners point out (Pet. 21), made no findings as to any losses that may have been sustained by investors is irrelevant. More than 20 years ago, in *Hughes* v. *Securities and Exchange Commission*, 174 F. 2d 969, 974 (C.A. D.C.), the court below sustained a similar broker-dealer revocation order, stating that "the revocation is proper even if one, or none, of the particular clients here involved has been misled or has suffered injury." [11] Public investors have a right to know all of the facts that might be relevant to their investment decisions, whether or not they choose to rely on those facts or suffer loss by ignoring them. Petitioners'

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[11] The court made this statement in the face of an amicus curiae brief filed on behalf of 120 of the broker-dealer's 175 clients urging reversal of the revocation because they believed they had been afforded "a high degree of investment protection, financial gain and security and financial peace of mind * * *" (*ibid.*).

customers might well have acted differently had they known of petitioners' systematic emphasis on high-commission securities and other facts withheld from them. In *Securities and Exchange Commission* v. *Capital Gains Research Bureau*, 375 U.S. 180, this Court held that an investment adviser's undisclosed practice of purchasing and selling the same securities that it recommended to its clients operated as a fraud upon those customers—despite the absence of actual injury—under the similar antifraud provision in the Investment Advisers Act of 1940, 15 U.S.C. 80b-6. As in the present case, the gravamen of the fraud in *Capital Gains* was the investment adviser's failure to disclose its "overlapping motivations". 375 U. S. at 196. Similarly, the Second Circuit has held that a broker-dealer who makes recommendations to his client at the client's request must disclose the fact that the broker-dealer is a market-maker in the securities recommended. See *Chasins* v. *Smith, Barney & Co.*, 438 F. 2d 1167, 1172.

CONCLUSION

For the foregoing reasons, the petitions for writs of certiorari should be denied.

Respectfully submitted.

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